Problems and Countermeasures of Starbucks' Development in China

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Abstract. With the development of Chinese economy, people have more disposable income and tend to pursue higher material goals. As the beverage with unique flavor and social function, coffee has gradually become a significant part of modern life, thus leading to more consumption of coffee in China. With the rise of domestic brand, the competition of freshly ground coffee industry has been intensified. Based on this situation, the paper is intended to analyze three present problems in the development of China business for Starbucks that has been entered in China for 26 years. These challenges are the loss of market share, slow expansion into sinking markets and increasing operating expenses. Meanwhile, focusing on these three key points, there are three effective measures put forward including maintaining market share, accelerating the speed of expansion in sinking markets and reducing unnecessary operating expenses. Therefore, this paper can serve as a reference for companies similarly with global business, thus helping them better enter new markets.

Keywords: Starbucks, China, Problems, Countermeasures.

1 Introduction

Since the reform and opening up, China's economy has undergone remarkable development in these years. As a result, people's income achieved huge growth and the source of income became diverse, thus improving the living standards of urban and rural residents significantly at the same time. In other words, people had more money to spend on consumption, thus boosting the pursuit of material life. According to the USDA, China's coffee consumption has increased by almost 150 percent in the last 10 years and is likely to continue growing in the future. However, compared with mature coffee consumption countries, there is still a great gap in China's coffee consumption. For example, from 2022 to 2023, China's coffee consumption was 4,200 thousand bags, while America's coffee consumption reached 26796 thousand bags. Therefore, China can be regarded as an emerging market for coffee, and it has great potential for future consumption demand.

Starbucks ranks as one of the world's premier roasters, marketers, and retailers of specialty coffee [1]. Besides, Starbucks has four brands such as Coffee, Teavana, Ethos, and Starbucks Reserve, and three segments that include North America, International,

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and Channel Development. In addition to coffee, Starbucks also has a wide range of other high-quality products such as tea, other beverages, and different kinds of food items. These products are all sold through three main channels, including company-operated stores, licensed stores, and the Global Coffee Alliance with Nestlé S.A. Besides, China market served as the second-largest market plays an important to Starbucks. By the end of fiscal year 2024, there were 7594 company-operated stores in China.

Since Starbucks entered the Chinese market in 1999, it grew rapidly. However, in recent years, with the rise of local outstanding brands represented by Luckin, Starbucks has encountered some problems in the development of the Chinese market, which is directly reflected in the decrease of net revenue. In fiscal year 2024, Starbucks China's net revenue was $3008.2 million, down 2.4% from 2023. The main issue lies in the loss of market share, slow expansion into sinking markets and increasing operating expenses. Therefore, the purpose of this study is to analyze these problems and put forward reasonable solutions. In this way, it can offer insights to other companies with global business on how to better localize their brand operations and cope with price competition.

2 Problems

2.1 Loss of Market Share

In recent years, the competition in China's coffee market has become increasingly fierce, and Starbucks' market share has been gradually weakened by local emerging brands and other international brands.

When it comes to local brands, Luckin Coffee and Cotti Coffee adopt the cost-leadership strategy that are characterized by cost-effective and high quality, thus capturing market share at a lighting speed [2]. Especially Luckin Coffee, surpassed Starbucks for the first time in terms of the number of stores in 2021, reaching about 6,024, and achieved higher net revenues than Starbucks China in 2023. In contrast, Starbucks has a relatively higher price for a single cup of coffee and the preference for customers to take away the order directly instead of enjoying third place in the fast-paced life.

With regard to other international brands like Costa and Peet's coffee, although these brands do not have as many stores as Starbucks, these brands also focus on high-end brand positioning and are committed to trying diverse ways to bring high-quality service to customers, thus bringing quite a few pressures to Starbucks at the same time.

As the result of the loss of market share, the net revenues in China market may face continuous decrease, and the net earnings will decline accordingly. In the long run, loyal customers may be reduced, and brands' reputation will be affected.

2.2 Slow Expansion into Sinking Markets

By the end of 2023, China had a total of 254 third tier, fourth tier, and fifth tier cities, thus accounting for approximately 87% of the total number of cities in China. At the same time, there were only about 40000 fresh coffee shops in these cities. Therefore, China owns a relatively hug sinking market.

Starbucks' strategy for expanding into China's sinking market began in September 2022. According to Starbucks China 2025 Strategic vision, the company plans to open 3,000 new stores in 300 Chinese cities at the rate of one store every nine hours. In 2023, Starbucks have already covered nearly 857 county-level and above cities in China and decided to accelerate the speed of sinking.

However, compared with Luckin, a rival in the same industry, Starbucks is sinking slightly more slowly. In 2023, Luckin had 5872 stores in sinking markets, while Starbucks has 1046 stores. But given different store expansion models, the slower speed can be understood, because Luckin adopts the method of joining and Starbucks insists on direct sales.

In addition to the above reasons, it may be mainly affected by the acceptance of higher coffee unit prices. Customers in the sinking market are more sensitive to price and are more likely to prefer cost-effective coffee. Therefore, it can be too high for these customers to drink a cup of coffee around 40 yuan. Besides, the demand for coffee in the sinking market may be low. Beacuse, in traditional Chinese culture, tea usually takes the lead as the most favored beverage, with coffee merely serving as an alternative [3].

As the result of slowly sinking market penetration, there will witness a continuous decline in market share and achieve the slower growth rate of net revenue in China market.

2.3 Rising Operating Expenses

In the past three years, the number of Starbucks stores in China has increased significantly from 5358 in 2022 to 7594 in 2024. Besides, Starbucks insists on providing customers with the unique Starbucks Experience that contains superior customer service, convenience, a seamless digital experience, as well as safe, clean, and well-maintained stores [1]. In this way, operating expenses including decoration and employee training cost a large sum of money.

Additionally, in the first half of 2024, there was an increase in rents in 50% of shopping malls in China's first-tier cities. Meanwhile, Starbucks have persistently made improvements in compensation, thus promoting the cost to rise.

As a result of high operating expense, Starbucks' profit margins will fall and its rapid store expansion plans may be stopped. Besides, the company may also cope with the liquidity risk.

3 Countermeasures

3.1 Maintaining Market Share

Facing the local competitors who have more stores and low-price advantages, it's advisable for Starbucks to take effective measures to maintain its existing market share.

Enhancing differentiation strategy: To tackle fierce industry competition, Coffee enterprises are advised to create distinctive brand recognition through unique brand stories, cultural connotations and product features [4]. Starbucks should stick to the strategy of offering high-quality products and superior services by emphasizing the quality of material and utilization of digital devices. In this way, it can consolidate the brand reputation and fully leverage its strength.

Enlarging the function of the third place: As core strengths, Starbucks can extend both its function and meaning. In terms of function, it can invite customers to fill out some online questionnaires on a regular basis to collect their suggestions for improvement. For example, the situation where several customers scramble for charging seats and occupy seats often happens in the store. Therefore, Starbucks can consider adding several seats equipped with charging ports in the store. With regard to the meaning, the third place is designed to foster a sense of community. There are a lot of community events held in the North America segment. Similarly, some activities such as reading sharing can be held in the store with low utilization of the third place.

Developing innovative products with good feedback: Creative products can be seen as possible revenue drivers. Starbucks owned fast speed to launch new products in fiscal year 2024, but few coffee products were as popular as Luckin's Sauce-flavored Maotai Latte and Coconut Milk Latte [5]. Therefore, Starbucks ought to check whether products are in line with the local taste and collaborate with the well-known local brands. Besides, the trend for consumers to pursue healthy beverages should be seized. For example, it's wise to continuously promote the 'True Flavor Sugar-Free' innovation series coffee. In addition to coffee, innovative designs of cups can also be seen as a powerful revenue driver such as the success of cat paw cups.

3.2 Accelerating the Speed of Expanding in Sinking Markets

Choosing appropriate locations: Starbucks stores are typically situated in high-traffic, high-visibility locations [1]. In third-, fourth-, and fifth-tier cities, priority should also be given to opening stores near shopping malls, office buildings, universities, scenic spots, highway stations and airports. The main reason is that these areas have relatively large passenger flow and people are more likely to accept higher prices of coffee or other products with higher demand for the third place.

Integrating local culture features to the third place: China owns vast territory and abundant resources so that diverse provinces and cities have their unique regional cultural characteristics especially remarkable in sinking markets. For ancient villages, Starbucks can combine local ethnic characteristics and enshrine the meaning of the third space as an 'intermediate landscape' between urban and rural areas [6]. Stores can be served as a gathering place for young people in the villages and a place to promote cultural heritage skills, thus promoting the development of tourism and facilitating employment for local people.

Promoting city-specific flavors: Starbucks can offer regional specialty coffee or other products, thus attracting more consumers in the sinking market. For example, combing the previous experience of innovating products such as Longjing Latte, more beverage integrated Longjing can be promoted in Zhejiang provinces. Besides, the price of products can be considered to reduce by discounting in the sinking markets, making people easier to accept the price.

3.3 Reducing Unnecessary Operating Expenses

Diversified store form: Starbucks can consider reducing store space or innovating store formats under certain circumstances. For example, stores with lower utilization of the third space can be transformed into online delivery-focused outlets, thereby reducing the costs of maintaining the third space. Besides, near urban parks, Starbucks can try to promote mobile coffee carts and place some simple tables and chairs around them, thus making full use of city space and lowering operating expenses in an innovative way [7].

Strengthening green supply chain: Starbucks has already established a coffee plantation base in Yunnan and set up its greenest and most energy-efficient production base globally in Kunshan, Jiangsu province [8]. In the future, Starbucks should continue to uphold the green concept from raw materials to distribution through digitization, thus reducing redundant costs. Besides, it can continuously develop sustainable cup materials and encourage customers to use their own cups with discounts.

Sustaining the current quality of store decoration and products: It was reported that Starbucks had poor hygiene and used expired ingredients in 2021, thus damaging its brand reputation [9]. Although operating expenses are rising year by year, it must insist on keeping the quality of its stores and products and cannot cut corners [10].

4 Conclusion

China's economy has significantly improved, and the pursuit of material life for residents has risen accordingly. Starbucks successfully seized the trend that more and more Chinese people fostered the habit of drinking coffee. However, encountering intense industry competition from both domestic and international brands, three core problems existed in Starbucks, loss of market share, slow expansion into sinking markets and increasing operating expenses namely. Hence, to tackle these issues, three effective strategies are proposed that include maintaining market share, accelerating the speed of expanding in sinking markets and reducing unnecessary operating expenses. Besides, three countermeasures also have certain reference value for studying how international coffee brands can achieve sustainable development in China and how other multinational companies can localize their brand operations and cope with price competition in new markets.

Meanwhile, there are some weaknesses in this paper. For example, in terms of the time span covered by the data, paper focuses on the data of Starbucks in China from 2022 to 2024, thus lacking the long-term trend or the latest dynamics of Starbucks in the Chinese market. Besides, the solutions to the corresponding problems might not be comprehensive enough.

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